



MEMORANDUM

INVESTMENT COMPANY INSTITUTE

December 24, 1997

12/29/97

Ms. Cynthia L. Johnson, Director
Cash Management Policy and Planning Division
Financial Management Service
U.S. Department of the Treasury
Room 420
401 14th Street, S.W.
Washington, D.C. 20227

Re: Conversion of Federal Payments to Electronic
Funds Transfer - Proposed Rule

Dear Ms. Johnson:

The Investment Company Institute¹ appreciates the opportunity to express its views on the Treasury Department's ("Treasury") request for comments regarding a proposed rule that would implement legislation requiring Federal agencies to convert all Federal payments (other than payments under the Internal Revenue Code) from checks to electronic funds transfer ("EFT").² The Institute's comments, as discussed below, recommend that the Proposed Rule should be revised to (1) permit Federal payments to be deposited into an investment account established through an investment company registered with the Securities and Exchange Commission ("SEC"), under the Investment Company Act of 1940, in the name of such investment company with whom the recipient has an account, and (2) clarify that where the payment recipient designates a mutual fund account, the recipient's interest would not be covered by deposit insurance.

Establishing Investment Accounts Through a Registered Investment Company

According to the Release, the Act requires recipients of Federal payments to (1) designate a financial institution (*i.e.*, a bank) or authorized agent to which the Federal payments shall be made, and (2) provide the agency making the payments with the information needed to make the payment by EFT. The Proposed Rule would also permit a Federal payment to be deposited into an investment account established through a securities broker or dealer registered under the Securities Exchange Act of 1934, in the name of such broker or dealer, with whom the recipient has an account. The Institute supports allowing Federal payments to be

¹ The Investment Company Institute is the national association of the American investment company industry. Its membership includes 6,718 open-end investment companies ("mutual funds"), 440 closed-end investment companies and 10 sponsors of unit investment trusts. Its mutual fund members have assets of about \$4.265 trillion, accounting for approximately 95% of total industry assets, and have over 59 million individual shareholders.

² Department of the Treasury, "Management of Federal Agency Disbursements" (September 11, 1997), 62 Fed. Reg. 48714 (September 16, 1997) (the "Release"). The Release notes that Section 31001(x) of the Debt Collection Improvement Act of 1996 (the "Act") amends Section 3332 of Title 31 of the U.S. Code to require Federal agencies to convert Federal payments from checks to EFT. The proposal would revise 31 CFR Part 208 (the "Proposed Rule").

deposited in such an account, but strongly believes that recipients of Federal payments should also be able to direct those payments to investment companies that are registered with the SEC ("mutual funds"), for the reasons noted below.

First, our recommendation would promote Treasury's goal of increasing participation in the nation's financial system by providing recipients of Federal payments with a variety of means for doing so. Second, the provision allowing designation of an account in the name of a broker or dealer already contemplates that Federal payment recipients may choose to use the proceeds of these payments to invest in securities (such as mutual funds). For those who wish to invest their Federal payments in mutual funds that are sold directly to investors, the ability to designate a mutual fund account would make the process much more efficient by eliminating the need to have the payment first deposited in the investor's bank account (or brokerage account) and then transferred (e.g., by check) to the mutual fund account.

Third, in discussing the Proposed Rule's provision allowing payments to be directed to an account in the name of a broker or dealer, the Release emphasizes that brokers and dealers are subject to an established registration and inspection scheme administered by the SEC.³ Like brokers and dealers, mutual funds are highly regulated entities. The structure and operations of mutual funds are subject to detailed requirements under the Investment Company Act of 1940. Mutual funds generally offer their shares to the public and, as such, must register them pursuant to the Securities Act of 1933 and make notice filings in states where they sell shares. Most mutual funds are externally managed, and many of their service providers also are regulated by the SEC. Mutual fund investment advisers must be registered under the Investment Advisers Act of 1940, and mutual fund transfer agents and mutual fund principal underwriters must register with the SEC under the Securities Exchange Act of 1934. All of the foregoing entities are subject to inspections by the SEC.⁴

Finally, the Institute notes that there is established precedent for this recommendation. Recently, the Internal Revenue Service, in order to minimize delays in processing tax refunds in the form of checks, revised its Form 1040 to allow taxpayers the added option of depositing their income tax refunds directly into a bank, a brokerage account, or a mutual fund.⁵ In addition, in the context of government allotments, Treasury already permits Federal payment recipients to have their payroll checks (or portions thereof) deposited into a financial institution in the name of and established through a mutual fund.⁶ We understand that social security payment recipients are provided a similar investment option through the Social Security Enrollment (ENR) Program.

³ See Release at 48722.

⁴ Although primarily regulated by the SEC, mutual funds also are regulated by the Internal Revenue Service, pursuant to requirements under the Internal Revenue Code, and are subject to state anti-fraud laws.

⁵ See Form 1040, Direct Deposit of Refund, Instructions to Lines 62b through 62d (1997).

⁶ See, e.g., Letter from Anthony R. Torrice, Chief Disbursing Officer, Operations Directorate, Department of the Treasury, Financial Management Service, to Joseph H. L. Jimenez, Vice President, USAA Shareholder Account Services, USAA Investment Management Company, dated November 16, 1995.

Clarifying Inapplicability of Proposed Deposit Insurance Requirements

As proposed, Section 208.6(b)(2) of the Proposed Rule would permit the deposit of Federal payments into an investment account at a financial institution in the name of a broker or dealer, provided the account and all associated records are structured so that the recipient's interest is protected under applicable Federal or state deposit insurance regulations. Treasury comments contained in the Release indicate that each such interest should be "*individually insured to the same extent it would be if the account were in the name of the recipient alone.*"⁷

The Institute opposes the application of such a requirement in connection with our recommendation to allow recipients of Federal payments to direct electronic transfers of those payments to mutual fund accounts, for a number of reasons. First, as a practical matter, the condition is unworkable. It is our understanding that for purposes of depositing Federal payments with a financial institution, the FDIC insurance coverage (which presently is limited to \$100,000 per account) would not attach to each individual recipient *per se*, but rather to the mutual fund, or other account owner, designated by the recipient to receive the payment. The costs and burdens of restructuring operations to establish and maintain a system that would provide individual FDIC coverage would far outweigh any possible benefit to the payment recipients who, as fund shareholders, ultimately would bear the costs of such restructuring.

Second, requiring deposit insurance of up to \$100,000 with respect to each individual Federal payment recipient is unnecessary⁸ and inappropriate. In this regard, we note that, as mentioned above, in other contexts, certain federal payments currently are permitted to be deposited in an investment account in the name of a mutual fund, without a deposit insurance requirement as proposed here. Moreover, both in those contexts and here, there would be no expectation that such coverage would be provided. It is important to note that a Federal payment recipient wishing to take advantage of the mutual fund option could do so only if he or she *has already established* a mutual fund account. Thus, pursuant to SEC requirements, those choosing this option will have received a prospectus describing the fund and its risks. In fact, in many cases, these individuals may already be fund shareholders and thus would have knowledge of the uninsured nature of an investment in the fund. Accordingly, the Proposed Rule should not impose specific deposit insurance requirements in connection with the direction of Federal payments to mutual fund accounts.

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⁷ See Release at 48722 (emphasis added).

⁸ The investment arrangement contemplates the Federal payment being made to a financial institution with account routing instructions (as pre-arranged by the recipient and the mutual fund) indicating the name of the mutual fund to which to direct the deposit. The transfer to the fund would occur almost immediately after being deposited in the bank (in most cases, less than 24 hours later).

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Thank you for considering our comments. If you have any questions or need additional information, please contact the undersigned at (202) 326-5923 or Frances Stadler at (202) 326-5822.

Sincerely,

A handwritten signature in cursive script, appearing to read "Barry E. Simmons".

Barry E. Simmons
Assistant Counsel